

Goldman Sachs The Markets

Can tech continue to dominate the markets?

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Sam Grobart: As big tech stocks continue to drive indices to record highs, we take a look at what's ahead. This is The Markets.

Hi, I'm Sam Grobart. Today I'm joined by Sung Cho, co-head of Tech Investing for Fundamental Equity within Goldman Sachs Asset Management. Sung, thanks so much for joining us today.

Sung Cho: Great to be here, Sam. Thank you.

Sam Grobart: Sung, as we sit here today, we're seeing tech stocks continue to contribute to record highs in indices like the S&P. The magnificent seven, the seven major tech companies account for almost a third of the S&P's value. This kind of dominance hasn't been seen in recent memory. I guess my main question to right now is

can it continue?

Sung Cho: Yeah. Look, I think that's a great question. I've been joking with my colleagues that it's years like 2023 that I'm thankful I'm a long only investor. Because going into the year, if you remember, we had runaway inflation. We had higher interest rates.

Sam Grobart: It was pretty bleak.

Sung Cho: We had a decelerating economy. And yet, you wake up and the NASDAQ's up 45 percent. And so, the dominance of tech has been really amazing.

But the reality of the returns in 2023 is that they were very concentrated in a few subsets of stocks. And actually, the small and mid-cap stocks, tech stocks, actually didn't fare all that well. It's just that the magnificent seven was up in average, 105 percent on the year.

Sam Grobart: So, years saying small/mid-cap stocks did fare pretty well?

Sung Cho: They did not fare.

Sam Grobart: They did not fare well.

Sung Cho: So, 2023 actually wasn't a very good year for fundamentals for tech stocks. It's just really the dominance of the magnificent seven that propped up the NASDAQ to be up 45 percent, right? And so, you know, as we fast forward to 2024, we think that narrative starts to change, and the leadership starts to change. Because we think that there's going to be actually a broadening of strength in the tech markets.

So, if you look at the last two years of the tech markets, tech actually undergrew its normalized trajectory. It only grew by 3 percent per year for the last two years when it typically grows about mid single digits. And we think 2024 is likely to be the first year where you see an acceleration in that growth rate, we think, to north of 6 percent.

Sam Grobart: Wow.

Sung Cho: So, any time you have fundamentals accelerate broadly, the leadership starts to change. And we think investors need to start paying attention to stocks

beyond the magnificent seven stocks to look for the best returns.

Sam Grobart: Is there anything on the horizon that you can imagine that would cause this kind of dominance to end? I mean, we usually see other industries, right, kind of take leadership and then they're cyclical and they move back down again. What would be something that would affect tech like that?

Sung Cho: Probably two major things. One is we've obviously built around a lot of AI infrastructure over the last 12 months. The Cloud guys have been focused on this. We've had semiconductor winners like NVIDIA as a result of the build out of infrastructure.

The question for 2024 is going to be is there an actual ROI on this investment? Like, an NVIDIA H100 processor costs \$30,000. That's like the price of a car. And so, companies are going to have to create new solutions and new products and applications that businesses and consumers are going to want to pay more for, right? If they're going to invest in this technology, they have to see a return.

And so, the question is going to be early on, as applications start to get rolled out, is there going to be an ROI? And if there isn't an ROI, maybe this does pause for a little bit. That's one thing that we're watching extremely carefully.

And then the second big thing is going to be the path rate of interest rates again. Does inflation start to accelerate again? We don't think so. But that's certainly a concern, right? If we get back into this hyper inflationary environment, the Fed has to pivot and repivot and hike rates again, certainly that affects tech valuations. I'd say those are the two big risks.

Sam Grobart: Right. A return to what happens in the '70s, for example, would be pretty bad if the Fed--

Sung Cho: Right.

Sam Grobart: -- had to reconfigure and recalibrate.

Sung Cho: Right.

Sam Grobart: I want to pull back to a slightly more global view. When we talk about tech and we talk

particularly about large tech companies, for the most part, not exclusively, but for the most part we tend to be talking about US companies. Most countries, most regions don't have these kinds of champion. How do they fare? How do they compete in markets when you have such a concentration in the US?

Sung Cho: So, I think there's a perception amongst US investors that there isn't a lot to invest in outside the United States. Actually, the reality is there are really big, growing ecosystems of tech beyond the US. And so, you have companies like Mercado Libre who's quickly becoming the Amazon of Latin America. You have a very fast-growing ecosystem of tech companies in India led by companies like Zomato. We all know a lot of the Chinese tech companies; they've had to build their own kind of internal ecosystem of tech giants.

And so, there is this very fast-growing ecosystem of non-US tech companies--

Sam Grobart: There may be a semiconductor producer or two as well.

Sung Cho: That's always been the case in Asia. So, we've always had relied on the semiconductor supply chain in Asia. So, there's always been a big kind of innovative companies there.

But in terms of the most innovative and the bleeding edge innovation for things like AI, still the US very much dominates. And as a result of that, most of the market cap still sits in the US.

Sam Grobart: This is a question I was actually talking a little bit about with some colleagues yesterday. When we look at even the magnificent seven, it includes Tesla, which is a car maker. It kind of raises for me the question of, like, what exactly is tech? How do you define it? It seems like different companies move in and out of it. It's like Amazon's also a retailer, but they have a, obviously, tremendous Cloud business. It seems like a fuzzy definition a little bit.

Sung Cho: Right, right, right. So, a greater portion of the US market is becoming defined as tech, increasingly. Right? And the way that we define it, we think over 50 percent of the US market is tech companies. And we think it's going to continue to grow. And increasingly, also, the

lines are blurring between what are tech companies and what are traditional companies because traditional companies are buying tech companies in order to drive innovation, right?

Ultimately, at the highest level, the way that you should think about what defines a tech company is companies that are innovating to allow consumers and enterprises to basically operate much more efficiently and much more productivity. Right?

So, think about internet companies. Certainly fits that definition. Think about software companies. Certainly fits that definition. FinTech. Neobanks. Certainly fit that definition. So, I think those are some of the bigger classes of what we would define to be classically tech.

And then you have the whole ecosystem of hardware, components, semiconductors, Cloud infrastructure suppliers.

Sam Grobart: All that supply chain.

Sung Cho: All of that stuff, that supply chain, that's

supporting that innovation would also be defined as tech. And if you define tech that way, it is more than 50 percent of the market.

But because the innovation is there, we think that it's just going to continue to increase as a percentage of the S&P 500 over time.

Sam Grobart: Sung, what's going to be on your radar for next week?

Sung Cho: So, next week, you know, it's the start of earnings week. We're going to hear from the mega cap tech giants. Google reports. Amazon reports. Microsoft reports. The thing that we're going to be focused on is the rate of Cloud growth. So, the market right now is very focused on the market share between the different Cloud players and the Cloud vendors. Who's actually winning in the AI world and the AI landscape.

Sam Grobart: The *Game of Thrones* of them.

Sung Cho: Right? And that's going to be the single biggest detriment of what moves these stocks over the next

couple of weeks, next couple of years even, you would argue, right? And so, we're going to be very much focused on kind of the relative growth rates that we see in the Cloud.

Sam Grobart: Sung, always a pleasure. Thanks so much.

Sung Cho: All right. Thanks for having me.

Sam Grobart: That does it for another episode of The Markets. Be sure to find us on Apple Podcasts, Spotify, or wherever you get your podcasts.

I'm Sam Grobart. Thanks so much for listening.

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